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Judge Whitman L. Holt
Chapter 11

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14 **UNITED STATES BANKRUPTCY COURT**
15 **EASTERN DISTRICT OF WASHINGTON**

16 In re

17 KING MOUNTAIN TOBACCO
18 COMPANY, INC.,

19 Debtor.

Case No. 20-01808

STATES' OBJECTION TO THE
ADEQUACY OF THE DEBTOR'S
DISCLOSURE STATEMENT

21
22 The States¹ object to the *Disclosure Statement for the Debtor's Plan of*
23 *Reorganization* ("Disclosure Statement" or "DS") [Doc. No. 155] because it
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25 ¹ "States" refers collectively to the tobacco regulatory agencies of the States of Indiana, South Carolina,
26 and New York—in all of which the Debtor has previously sold tobacco products (although not it is not doing so currently) and all of which are creditors in this bankruptcy case.

1 fails to provide adequate information as required under § 1125 of the
2 Bankruptcy Code. Specifically, disclosures on the below matters are inadequate
3 because they fail to provide sufficient information for the States to reasonably
4 determine if the Debtor's Plan of Reorganization ("Plan") [Doc. No. 156] is
5 feasible or has an adequate means of implementation. The States also join in the
6 *United States' Opposition to Debtor's Disclosure Statement* [Doc. No. 196].
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9 **Regulatory Background**

10 The States regulate the Debtor's sale of cigarettes and other tobacco
11 products in their respective states. As part of their regulatory responsibilities,
12 the States enforce laws that require the Debtor, as a "Non-Participating
13 Manufacturer" ("NPM")², to deposit into an escrow account, held for the benefit
14 of each State, a set amount per cigarette unit sold in that State (referred to
15 collectively as the "Escrow Statutes").³ The per cigarette deposit amount
16 increases each year based on an inflation adjustment, and for cigarettes sold in
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21 ² Tobacco manufacturers fall into two categories: those that have settled with the States and become
22 "Participating Manufacturers" or "PMs" under the tobacco Master Settlement Agreement ("MSA") executed in
23 November 1998 and that make direct payments to the States in recognition of the health care costs imposed by
24 their products; and those that have not settled, the NPMs, who must instead make deposits into an escrow account
that are roughly equivalent in cost to the payments made by the PMs. The escrow account holds funds that may
be utilized to satisfy judgments obtained by the States in cases filed against the NPMs with respect to their
tobacco sales that could be of the nature as those that were settled against the PMs in the MSA.

25 ³ Each State has an Escrow Statute requiring NPMs to make escrow deposits on their cigarette sales, and
26 these laws are nearly identical to each other. As an example, South Carolina's escrow statute is codified at S.C.
Code Ann. §§ 11-47-10-40.

1 calendar 2020, the per carton amount was \$7.37. Failure to make timely escrow
2 deposits can result in removal of the Debtor from a State's directory of approved
3 tobacco manufacturers (a process called "delisting"). Once removed from the
4 directory, a tobacco manufacturer must immediately stop making any further
5 cigarette sales in that state, and its existing product typically becomes unlawful
6 contraband subject to seizure.⁴
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9 **States' Treatment under the Plan**

10 Several years before the Debtor filed for bankruptcy, it had been certified
11 to sell tobacco products in South Carolina and Indiana but was delisted by each
12 State when it failed to make its required escrow deposits for cigarettes sold
13 there. In 2015, King Mountain entered into a settlement agreement with the
14 State of Indiana whereby it agreed to pay all its past due escrow deposits (about
15 \$4.9 million) over a period of 13 years. Only once fully paid, the Debtor could
16 reapply to be listed on Indiana's directory. In 2016, the Debtor entered into a
17 similar settlement agreement with the State of South Carolina. Under this
18 settlement, it agreed to pay about \$2.9 million in past due escrow over a period
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25 ⁴ The laws requiring tobacco companies to be listed on a directory of approved manufacturers are called
26 "Directory Laws" and were passed by the States to enhance their ability to enforce their Escrow Statutes. Each
State has passed Directory Laws, and they are substantially the same. As an example, South Carolina's Directory
Laws are codified at S.C. Code Ann. §§ 11-48-10-110.

1 of 14 years—at the end of which it could reapply to be listed on South
2 Carolina’s directory.

3 Under the Plan, the Debtor proposes to pay the outstanding portion of
4 these escrow obligations (\$3.5 million for Indiana and \$2.5 million for South
5 Carolina) over a period of 12 years for Indiana and 14 years for South Carolina.
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7 The State of New York is not listed as a creditor in the Debtor’s schedules
8 but has been investigating the Debtor’s conduct and anticipates filing a proof of
9 claim for past due escrow owed on cigarette sales made in New York and for
10 penalties arising from the Debtor’s failure to comply with the Prevent All
11 Cigarette Trafficking Act of 2009 (“PACT Act”), 15 U.S.C. §§ 376(a)(1) and
12 (2), relating to unlawful shipments of cigarettes into New York. New York seeks
13 certain sales records and PACT Act reports from the Debtor to complete its
14 claim. The Plan does not provide for treatment of this anticipated claim.
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18 **Inadequate Information in the Disclosure Statement**

19 The Disclosure Statement fails to provide adequate information about the
20 below matters, without which the States cannot make an informed decision
21 about the Plan:
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23 1. **The Debtor’s calendar year 2020 financial performance.** While
24 the Disclosure Statement provides financial statements for calendar years 2018
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1 and 2019, there is nothing that covers 2020. The States cannot make an
2 informed decision about the feasibility of the Debtor's Plan without financial
3 statements covering 2020. The Disclosure Statement should include the same
4 financial statements for 2020 as it does for 2019 and 2018.
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6 **2. The factual basis for the Debtor's 5-year projections.** The
7 Debtor's 5-year projections (2021-2025) predict a steady increase in Tobacco
8 Sales, Total Cash Receipts, and Net Cash Flow (DS, Ex. A at p. 1) in each post-
9 confirmation year, but there is no factual basis provided in the Disclosure
10 Statement to support these increases. For example, the Debtor projects that
11 Tobacco Sales will increase by about \$500,000 each year from 2021 through
12 2025, but its Income Statements for 2018 and 2019 (DS, Ex. B at p. 8 and Ex. C
13 at p. 14) show that its Tobacco Sales dropped by about \$700,000 from 2018 to
14 2019.
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16 Similarly, net income for 2018 and 2019 is -\$6.5 million and -3.6 million
17 respectively. (DS, Ex. B at p. 5 and Ex. C at p. 14.) Yet, the Net Cash Flow for
18 the Debtor's projections show an ever-increasing amount of cash, growing from
19 \$162,000 in 2022, to \$722,000 in 2025. (DS, Ex. A at p. 1.) There is no
20 explanation in the Disclosure Statement for these significant improvements in
21 the Debtor's tobacco manufacturing operations. The Disclosure Statement fails
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1 to provide any factual basis for the Debtor's belief that its tobacco sales will
2 continue to rise in each of the next five years and that its profitability will
3 similarly improve; yet, these metrics are essential to providing it with sufficient
4 cash to make its Plan payments to creditors. Without this additional
5 information, the Disclosure Statement lacks adequate information on which the
6 States can make a decision about the feasibility of the Plan.
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9 **3. Payments from Affiliates.** In the Disclosure Statement, the Debtor
10 identifies several Affiliates for which it has provided start-up financing—
11 specifically, Wheeler Fuel Distribution, Wheeler's Pawn Stars, and Wheeler
12 Rock Products. (DS, pp. 14-5.) Under the Plan, these Affiliates are required to
13 repay these debts to the Debtor over the next four to five years. Collectively,
14 these debts total about \$2.1 million. No information is provided in the
15 Disclosure Statement about the financial ability of these Affiliates to repay these
16 debts or the repayment terms other than the total number of years. The
17 Disclosure Statement should set forth all material repayment terms, including
18 interest rate and frequency of payments. In addition, the Disclosure Statement
19 should include financial statements for 2020 and 2019 for each of these
20 Affiliates. The Debtor should also clarify if it intends to continue to provide
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1 financing or have any business transactions with these Affiliates during the first
2 five years following confirmation.

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4 **4. On-going business relationships with Affiliates.** The Debtor
5 appears to have on-going business relationships with several Affiliates including
6 Mountain Tobacco Distributing, Wheler Fuel Distribution, Wheeler Kountry
7 Korner, Wheeler Smoke N Gas, and Wheeler Cattle. (DS, pp-14-5.) The Debtor
8 should clarify in its Disclosure Statement if it intends to continue to do business
9 with any of these Affiliates (or any other Affiliate) post-confirmation, and, if so,
10 identify the financial terms of these relationships so that creditors can determine
11 if these are arms-length transactions that provide the Debtor with reasonably
12 equivalent value or, if instead, the transactions are actually subsidies that keep
13 these Affiliates financially afloat to the detriment of the Debtor.

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15 For example, the Debtor states that it pays the wages and salaries for
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17 Wheeler Cattle and that this Affiliate repays these costs “as cattle is sold”. (DS,
18 at p. 15.) The Debtor also discloses that Wheeler Cattle owes the Debtor about
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20 \$2 million in pre-petition debt the repayment of which is also dependent on
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22 future cattle sales. *Id.* The Disclosure Statement should explain why the Debtor
23
24 continues to finance the operations of this Affiliate and explain, what if any,
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26 financial benefit this continuing relationship provides to the Debtor.

1 Conversely, if there is no benefit, the Debtor should disclose the financial loss
2 that this relationship is expected to cost the Debtor in 2020 and in each of the
3 five years post-confirmation.
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5 Similarly, the Debtor should disclose the factual basis on which its asserts
6 in that “all transactions between [the Debtor and Affiliates, Wheeler Kountry
7 Korner and Wheeler Smoke N Gas,] are at arms’ length.” (DS, at p. 14.)
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9 **5. Consolidated Financial Statements.** To the extent the Debtor’s
10 tobacco manufacturing operations are financially intertwined with Affiliates like
11 Wheeler Cattle, Mountain Tobacco Distributing, Inc., Wheeler Kountry Korner,
12 Wheeler Smoke N Gas, and any other Affiliate, the Disclosure Statement should
13 include consolidated financial statements with all such Affiliates covering 2018,
14 2019, and 2020; otherwise, it is not possible for creditors to determine whether
15 the Debtor’s business operations benefit from these relationships or are merely
16 subsidizing unprofitable Affiliates.
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19 **6. Post-confirmation compensation for management.** The Debtor
20 states that Trina Wheeler, the 100% owner of the Debtor and its Manager and
21 President, does “not draw a salary from the Debtor”. (DS at p. 15.) The Debtor
22 should disclose how Ms. Wheeler is compensated for her work for the Debtor
23 and whether her compensation will change post-confirmation, and if so, how.
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1 With respect to the other officers and directors of the Debtor, their post-
2 confirmation compensation also needs to be disclosed.

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4 **7. Chapter 7 liquidation analysis.** The Debtor provides a brief
5 narrative estimating the liquidation value of its Qualified Escrow Fund accounts
6 but fails to provide a liquidation value for any of its other assets. (DS, at p. 19-
7 20.) The Disclosure Statement should provide a spreadsheet listing all the
8 Debtor's current estimated administrative expenses, priority expenses, secured
9 and unsecured claims, together with the Debtor's estimated values for each asset
10 (including equipment, accounts receivable, fraudulent transfer claims, etc.),
11 including the source for these values. The liquidation analysis should also
12 provide a present value calculation of the payment to creditors under the
13 proposed plan versus payment under a liquidation. Without this information, it
14 is not possible for the States to determine if they would receive more under a
15 Chapter 7 liquidation than under the Plan.
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1 WHEREFORE, the States ask that the court deny approval of the
2 Disclosure Statement.

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4 DATED this 2nd day of February, 2021.

5 ROBERT W. FERGUSON,
6 Attorney General

7 /s/ Dina Yunker
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By /s/ Patricia Molteni
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